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Senate Committee on Banking & Financial Institutions Meeting
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# INTERCHANGE AND FEE AND SERVICE CHANGES

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## HISTORY OF INTERCHANGE FEES

- 1958 – Bank of America begins BankAmericard (predecessor to Visa).
  - Established fees to pay for the service
    - Annual Fee – paid by card users
    - Interest Rates – paid by card users
    - Per Transaction Fees – paid by merchants
- 1966 – BankAmericard allows other banks to use the card as *franchisees.*
- 1970 – BankAmericard becomes a multiparty corporation/system which eventually becomes VISA.
  - Sets first interchange fee at 1.95% per transaction
  - Fee eventually set at $.42 per transaction

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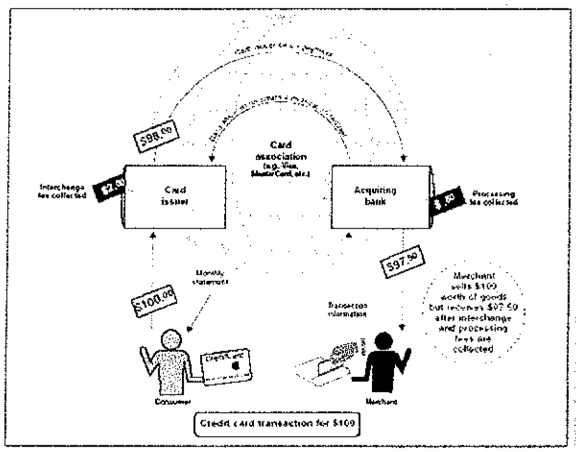
# HOW DOES IT WORK?

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# HISTORY OF INTERCHANGE FEES

- What did the early interchange fee provide?
  - Remember this was in the days of armored cars taking carbon paper to processing centers.
  - Cost included
    - Data inputs
    - Paper shuffling
    - Computer software/system infrastructure development
    - Coverage for fraud, theft, and abuse losses
  - In return, retailers received the convenience of immediate payment and decreased bad check presentations and bad debt management costs.

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## WHAT WAS THE PROBLEM?

- As more Americans used credit and debit cards, economy shifted to cashless community.
- As activity increased, virtual cost of managing transactions decreased thanks to improvements in computer speed and software development.
- Retailers continued to enjoy benefits of speed and safety with no fraud, loss or credit abuse risks. They did not wish to pay for these benefits.

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## DODD FRANK ACT (DFA)

- Sen. Durbin (D-Illinois) offered an amendment that ordered the Federal Reserve to set interchange fee at $.26.
- DFA makes no effort to address the fact that financial institutions must cover the entire cost for any fraud or abuse.
- DFA makes no effort to ensure that retailers reduce the prices they charge for products despite having a lower interchange fee.
- DFA makes it so that the retailer no longer has to pay for the costs of someone else to take care of all processing related to the convenience of using a credit/debit card.

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## MYTHS ABOUT INTERCHANGE FEES

- The interchange fee is a hidden fee paid by consumers.
  - FACT: Interchange fees are paid by retailers and businesses in exchange for a card payment system that is more efficient and cost effective than cash or checks.
- Businesses are required to accept cards for payment.
  - FACT: Retailers choose to accept cards for payment. They can choose to accept some cards and not others or only cash or checks. Retailers have the ability to discount for cash and checks and let consumers decide if they want to pay for the convenience of payment cards. They do not as a rule because cash and checks are costly transactions.

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## MYTHS ABOUT INTERCHANGE FEES

- Retailers and Businesses don't get guaranteed payment from card transactions.
  - FACT: They are guaranteed payment if they swipe the card and obtain authorization. Retailers only lose if they fail to obtain authorization or make an error in processing.
  - But even in cases where there are insufficient funds or there's a counterfeit card, the retailer gets paid and the bank that issued the card suffers the loss.
  - THE BANK (Currently) PAYS FOR THE FRAUD.

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## MYTHS ABOUT INTERCHANGE FEES

- Thanks to the Durbin Amendment, the consumers will pay less.
  - FACT: There really are no savings in Durbin it is a cost shift.
  - Retailers have successfully shifted the cost they assumed for increased business efficiencies to consumers.
  - Because the Congress has placed an artificial price cap on these transactions, financial institutions will need to cover costs in other ways, including adding or increasing fees on checking accounts, limiting the dollar amount for which a debit card may be used, creating insurance products to cover losses from fraud and theft, reducing the risk profile of the card holder, decreasing promotions and reward programs (free checking and air miles).

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## WHERE DO WE GO FROM HERE?

- Old Interchange fee structure, which was profitable allowed for:
  - Protection from losses due to fraud, theft, & abuse
  - Profits used to provide "free checking"
- New Interchange fee structure will cause costs to be shifted to someone and lead to:
  - Fewer "rewards"
  - Fewer new products
  - New annual fees
  - New insurance premiums

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# CHANGE IS INEVITABLE


"Any payment system that does not cover the fixed costs of that system will not survive."

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